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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN RE: TIME WARNER INC.
SECURITIES LITIGATION.

ZVI TRADING CORP. EMPLOYEES'
MONEY PURCHASE PENSION PLAN AND TRUST
and BARRY ZONON,

Cross-Petitioners,

vs.

STEVEN J. ROSS, N.J. NICHOLAS, JR.,
GERALD M. LEVIN, BERT W. WASSERMAN,
and TIME WARNER INC.,

Cross-Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether the decision below that petitioners' statements prior to May 1, 1991, "hyp[ing] strategic alliances" were not actionable as a matter of law undermines the philosophy of full disclosure underlying the federal securities laws and conflicts with this Court's decision in Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991)?

II. Whether the court below improperly concluded that Federal Rule of Civil Procedure 9(b) requires dismissal of plaintiffs' allegations of fraudulent statements by corporate "spokespersons" whose names cannot be ascertained by plaintiffs prior to discovery and, therefore, cannot be recited in the complaint?

PARTIES TO THE PROCEEDING

Respondents and cross-petitioners, plaintiffs in the district court and appellants in the court of appeals, are ZVI Trading Corp. Employees' Money Purchase Pension Plan and Barry Zonon. Petitioners and cross-respondents, defendants in the district court and appellees in the court of appeals, are Time Warner Inc., Steven J. Ross, N. J. Nicholas, Jr., Gerald M. Levin and Bert W. Wasserman.

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CONDITIONAL CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Respondents hereby cross-petition for a writ of certiorari to review certain aspects of the opinion of the United States Court of Appeals for the Second Circuit. Respondents respectfully request that the Court consider this conditional cross-petition only in the event that the Court grants the petition for a writ of certiorari.

OPINIONS BELOW

The opinion of the court of appeals is reported at 9 F.3d 259, and also is set forth in the appendix attached to the petition for a writ of certiorari (Pet. 14a-42a). The district court's opinion, reported at 794 F. Supp. 1252, as well as the district court's opinion denying

reconsideration, 1992 U.S. Dist. LEXIS 10057 (Pet. 43a-45a), also are set forth in petitioners' appendix (Pet. 46a-67a).

JURISDICTION

The judgment of the court of appeals was entered on November 30, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The statutory and regulatory provisions involved in this cross-petition are Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5.

> § 78j. Manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or

instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the

public interest or for the protection of investors.

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

> in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

Cross-petitioners respectfully refer the Court to their brief in opposition to the petition for a writ of certiorari for a complete discussion of the background facts and the decision of the Second Circuit.

REASONS FOR GRANTING THE CROSS-PETITION

In holding that petitioners' statements prior to May 1, 1991, regarding strategic alliances were not actionable and, therefore, did not give rise to a duty to disclose the problems that developed in petitioners' strategic alliance negotiations, the Second Circuit's decision undermines the policies of full disclosure underlying the

federal securities laws and conflicts with the decisions of this Court. In addition, the Second Circuit's holding that Federal Rule 9(b) requires that plaintiffs, without the benefit of discovery, must, at the pleading stage, identify the speaker when allegedly fraudulent statements in newspaper stories and analyst reports are attributed to "unnamed" company spokespersons, contravenes the policies underlying Rules 8(a), 9(b), and 12(b)(6); ignores the impact these statements have on the securities markets; and undermines the philosophy of full disclosure that is the bedrock of the federal securities laws.

ARGUMENT

I.

THE SECOND CIRCUIT INCORRECTLY CONCLUDED THAT PETITIONERS' PRE-MAY 1, 1991 STATEMENTS WERE NOT ACTIONABLE AS A MATTER OF LAW

The complaint alleges that, during the class period, petitioners disseminated a series of positive and optimistic statements concerning the creation of various strategic alliances with third-party investors (Pet. 20a, 21a n.2). The Second Circuit itself accepted as true the proposition that petitioners "publicly hyped strategic alliances" (Pet. 29a), and conveyed "generally positive messages" regarding petitioners' search for strategic alliances (Pet. 17a). The district court similarly found that petitioners' statements concerning strategic alliances were designed to

"drum up enthusiasm for Time Warner stock by proclaiming the advantages possible 'strategic alliances' could offer the company and its would-be partners and by reporting that negotiations were underway" (Pet. 55a).

Notwithstanding these findings, the Second Circuit held that petitioners' pre-May 1, 1991, statements concerning Time Warner's pursuit of and attempts to negotiate strategic alliances were not actionable under the federal securities laws. According to the Second Circuit, petitioners' statements lacked the "definite positive projections" that might require later correction (Pet. 26a). Thus, the Second Circuit erroneously held that petitioners had no legal obligation to disclose publicly that

their strategic alliance negotiations were proceeding unsatisfactorily, as plaintiffs had alleged. In so ruling, the Second Circuit fundamentally ignored: (1) the impact of petitioners' statements on the market price of Time Warner's common stock; (2) the materiality of petitioners' statements, which give rise to duties of disclosure under Basic, Inc. v. Levinson, 485 U.S. 224 (1988), and its progeny; and (3) the holding of this Court in Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991), that general statements of opinion, belief, and optimism are actionable under the federal securities laws.

The market had an overwhelmingly positive reaction to petitioners' statements concerning strategic alliances. On December 12, 1990, the

first day of the class period, petitioners' stock traded at approximately $86 per share. By May 1, 1991, petitioners' stock price had soared to approximately $112 per share. This dramatic 30% increase in the price of Time Warner's common stock was directly attributable to petitioners' continuous conditioning of the market to expect the consummation of one or more strategic alliance transactions. Petitioners' statements through the close of the class period continued to stimulate the market. On June 3, 1991, three days before petitioners' disclosure of a rights offering and three days before the close of the class period, defendants' stock climbed to $119 per share.

The market action of Time Warner's stock in response to

petitioners' statements evidences the materiality of those statements. See, e.g., In re Apple Computer Securities Litigation, 886 F.2d 1109, 1116 (9th Cir. 1989), cert. denied, 496 U.S. 943 (1990) ("Dramatic price movements in response to an optimistic statement would provide a strong indication that the statement itself was material...."); 5B Jacobs, Litigation and Practice under Rule 10b-5 § 61.01[b] n.69 (2d ed. 1992) ("The market reaction to a statement correcting a prior release should be evidence that the prior release was misleading"). The Second Circuit, however, failed to consider the materiality of the challenged statements, and instead found that the statements were not actionable as a matter of law. Thus, the Second Circuit completely ignored the

substantial increase in the company's stock in response to petitioners' statements throughout the class period.

Likewise, the court of appeals' holding that petitioners' statements were not actionable because they suggested only the "hope" that talks would go well is inconsistent with well-settled law. In Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991), for example, the Supreme Court held that statements by corporate directors in a proxy statement that the value shareholders would receive for their stock in a merger was "high," and that the price was "fair," were actionable under the federal securities laws. Id. at 2755. The Supreme Court reached this conclusion despite the defendants' contentions that the statements on

which liability was predicated -- "high" and "fair" -- were "indefinite and unverifiable" terms. Id. at 2758. The Court concluded that:

> The objection ignores the fact that such conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading. Provable facts either furnish good reasons to make a conclusory commercial judgment, or they count against it, and expressions of such judgments can be uttered with knowledge of truth or falsity just like more definite statements, and defended or attacked through the orthodox evidentiary process that either substantiates their underlying justifications or tends to disprove their existence.

Id. at 2758-59 (emphasis added). See also Mayer v. Mylod, 988 F.2d 635, 639-40 (6th Cir. 1993) (bank's statements that it intended to have

strong financial controls and that its loan portfolio was "soundly underwritten" were actionable under federal securities laws); Hanon v. Dataproducts Corp., 976 F.2d 497, 501-03 (9th Cir. 1992) (corporation misled market by touting new product line despite technical problems); Shapiro v. UJB Financial Corp., 964 F.2d 272 (3d Cir.), cert. denied, 113 S. Ct. 365 (1992) (statements by corporate management utilizing such general labels as "conservative" and "cautious" in describing a corporation's lending practices and loan loss reserves can be a basis for federal securities violations). Petitioners' statements at issue in this case are of precisely the nature recognized by the authorities mentioned above as material, and

therefore actionable, under the federal securities laws.[1]

The Second Circuit's broad pronouncement that only definite and concrete public statements may be actionable under the federal securities laws seriously undermines, if not eliminates, the ability of defrauded investors to seek redress for their injuries in a wide variety

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[1] The Second Circuit also refused to find petitioners' pre-May 1 statements actionable because "[n]o identified defendant stated that he thought deals would be struck by a certain date, or even that it was likely that deals would be struck at all" (Pet. 26a). The court of appeals' reading of the challenged statements is not correct. For example, on November 30, 1990, plaintiffs allege that defendant Ross said that the company "continues to have serious talks that could lead to the sale of five or six separate minority stakes in its entertainment subsidiaries next year" (Pet. 24a n.3) (emphasis added). In making this statement, petitioners not only indicated that it was likely that deals would be struck but further specified a date of "next year." Likewise, on March 15, 1991, defendant Nicholas gave the impression that deals were imminent, if not being made at the time, when he affirmatively stated that "[w]e're partnering" (Pet. 24a n.3).

of situations and "subvert[s] the 1934 Act's efforts to protect investors from deliberate fraud." In re Ames Dep't Stores, Inc. Stock Litigation, 991 F.2d 953, 963 (2d Cir. 1993). As this Court instructed in Basic, Inc. v. Levinson, 485 U.S. 224, 230 (1988): "There cannot be honest markets without honest publicity." See also Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 477-78 (1977) (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963)). In addition, this Court has emphasized that the provisions of the Exchange Act should receive the broad construction and remedial application their legislative history and language require. Bateman Eichler, Hill Richard, Inc. v. Berner, 472 U.S. 299 (1985); Herman & Maclean v.

Huddleston, 459 U.S. 375 (1983). The Second Circuit's decision allows corporate defendants to escape all consequences for the deceptive inflation of their prospects by having no accountability for their public utterances.

II.

PLAINTIFFS NEED NOT IDENTIFY THE CORPORATE "SPOKESPERSON" WHO MAKES FRAUDULENT STATEMENTS TO SURVIVE A MOTION TO DISMISS UNDER RULES 9(b) AND 12(b)(6)

The complaint alleges that certain of the challenged statements were made by company spokespersons and publicly reported by securities analysts, media persons, and other members of the investment community (Pet. 21a n.2). These statements were similar in nature and content to those directly attributed to petitioners. As evidence of this, the analyst reports consistently

refer to "[m]anagement [having] indicated" or "[a]ccording to the company."

The Second Circuit held that these statements did not satisfy Federal Rule 9(b). According to the Second Circuit, claims of misrepresentation concerning "completely unattributed statements" will be dismissed "even when the plaintiff alleges on information and belief that the unattributed statement was made by an agent of the defendant" (Pet. 23a). In holding that the unattributed statements were not actionable, the court of appeals reasoned that the function of analysts and reporters "is to determine the truth about the affairs of publicly traded companies," and, therefore, that few analysts and reporters would participate in

efforts to disseminate fraudulent statements. Id.

The Second Circuit's rationale misses the point. The issue is not whether analysts and reporters would participate in efforts to disseminate fraudulent statements. The issue is whether it was error to establish a Draconian Rule 9(b) barrier that enables -- indeed encourages -- corporate representatives to exploit business media of mass communications to manipulate the introduction of information into the marketplace under a cloak of anonymity that is impenetrable without discovery.[2]

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[2] The court's stated rationale for requiring the speaker's identity also was recently criticized in an article appearing in the New York Law Journal, Dennis J. Block and Jonathan M. Hoff, "Duty to Correct Forward Looking Disclosure," New York Law Journal, Feb. 17, 1994, at 5. There, the authors noted that the Second Circuit's decision:

(continued...)

The Second Circuit's opinion further contravenes public policy by ignoring the realities of how information is disseminated throughout the marketplace and how it is communicated to and relied upon by investors. Other courts have recognized that analysts, news reporters, and other members of the investment community are the instruments through which information is publicly disseminated and relied upon by investors in valuing a company's present and future

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[2](...continued)

> [I]s based on the questionable premise that reporters and analysts are able to determine when they are being provided with false and misleading information. Regardless of its underpinnings, the Second Circuit decision may increase the willingness of corporations to provide information to reporters and analysts as long as it is on an unattributed basis.

Id. at 8 (emphasis added).

prospects. See, e.g., Basic, 485 U.S. at 246 & n.24 ("market professionals generally consider most publicly announced statements about companies, thereby affecting stock market prices."); Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 514-15 (7th Cir. 1989) (analysts served to interpret company statements); In re Apple Computer Sec. Litigation, 886 F.2d 1109, 1116 (9th Cir. 1989), cert. denied, 496 U.S. 943 (1990) (court acknowledged that press reports fully explained what defendants had not). The Second Circuit, however, ignored these fundamental principles and erroneously concluded, without any legal or factual basis whatsoever, that "investors tend to discount information in newspaper articles and analyst reports when the author is

unable to cite specific, attributable information from the company" (Pet. 23a).

The Second Circuit's opinion not only is in conflict with public policy and the realities of the marketplace, but is also inconsistent with relevant legal authority governing the actionability of statements by corporate spokespersons. In In re Ann Taylor Store Securities Litigation, 807 F.Supp. 990, 1004 (S.D.N.Y. July 27, 1992), for example, the court specifically rejected the notion that Rule 9(b) requires a plaintiff, prior to discovery, to identify by name a company spokesperson whose statement is alleged to be materially misleading. The court held: "Prior to discovery, plaintiffs are not expected to pinpoint precisely who

uttered the statements." Id. at 1004. The court's rationale in rejecting a construction of Rule 9(b) that would be impossible to comply with in many situations is compelling:

> [T]o require more would defeat the purpose of the securities laws since any corporation could avoid liability under the 1934 Act, through the abuse of Rule 9(b), by simply issuing false and misleading statements through an anonymous spokesperson instead of a named officer or director.

Id.

Likewise, in In re Columbia Securities Litigation, 747 F. Supp. 237, 245 (S.D.N.Y. 1990), the court held:

> While defendants certainly had less than complete control over what the reporter wrote, they did have control over what Mr. Schulof said. If, as class plaintiffs allege, Mr. Schulof made a false

> statement to the Forbes reporter, that statement may properly serve as a basis for class plaintiffs' fraud claim.

See also Panzirer v. Wolf, 663 F.2d 365, 366-67 (2d Cir. 1981) (court allowed plaintiff to proceed following reliance on a news column reporting unattributed analysts' reports and reliance on Standard and Poor's tearsheets); Cytryn v. Cook, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,409, at 97,016 (N.D. Cal. July 2, 1990) (court ruled that "where the discovery has not taken place and the information is in the sole possession of the defendant, identities need not be specified").[3]

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[3] The Second Circuit's purported distinction of various authorities bearing on the actionability of non-attributed statements was in many cases attenuated or incorrect. For example, the court below distinguished Elkind v. Liggett & Meyers, Inc., 635 F.2d 156 (2d Cir. 1980), on the ground that defendants had placed their

(continued...)

Plaintiffs in this case had no discovery prior to serving the consolidated complaint. The limited document discovery they were permitted thereafter did not reveal which Time Warner spokespersons or members of management uttered the statements alleged to be misleading. Moreover, the identities of the Time Warner representatives whose statements are challenged is information in the possession of

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[3](...continued)
"imprimatur" on analyst reports. Elkind, however, stands for the proposition that, when the facts justify it, it may be reasonable to infer an imprimatur, either express or implied. The Second Circuit attempted to distinguish Alfus v. Pyramid Technology Corp., 764 F. Supp. 598 (N.D. Cal. 1991), on the same ground. Alfus, however, stands for the same unremarkable proposition as Elkind that the determination of whether defendants have placed an imprimatur on others' statements is factually driven. Finally, the Second Circuit attempted to distinguish In re Ann Taylor Securities Litigation, 807 F. Supp. 990 (S.D.N.Y. 1992), on the basis that it involved press releases. Ann Taylor in no way limited its holding to official press releases, however.

petitioners -- not plaintiffs. Thus, it is completely unreasonable to require plaintiffs to provide the detailed information the Second Circuit said was necessary under Rule 9(b). This especially is true in light of the fact that petitioners would not be burdened from limited discovery requesting them to disclose the names of the spokespersons whose statements are alleged to be fraudulent.[4] As observed in In re Craftmatic Securities Litigation, 890 F.2d 628, 645 (3d Cir. 1989) (citation omitted), "[c]ourts must be sensitive to the fact that application of Rule 9(b) prior to discovery 'may permit sophisticated

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[4] This Court should, at the very least, grant plaintiffs in the situation presented in this case leave to take limited and narrowly-tailored discovery to identify the "spokespersons" whose statements are challenged in the complaint.

defrauders to successfully conceal the details of their fraud.'"[5]

In sum, petitioners should not be immunized from liability by a Draconian application of Rule 9(b) that enables corporate spokespersons to speak anonymously and make misleading and partial disclosures to securities analysts, the media, and others with full knowledge that the information will be widely disseminated to and relied on by the investing public. Common sense makes

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[5] The court's opinion would also exculpate defendants for omitting information that was otherwise disseminated into the marketplace through analysts' reports and statements by the press, but, through a rigid application of Rule 9(b), deny plaintiffs the ability to rely on those same statements to establish defendants' liability. See, e.g., Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1262 (4th Cir. 1993) (granting summary judgment on the ground that press reports of "negative publicity apprised the market of [defendant's] fiscal difficulties"); In re Apple Computer Securities Litigation, 886 F.2d 1109, 1116 (9th Cir. 1989), cert. denied, 496 U.S. 943 (1990) (same).

it obvious that it is virtually impossible for plaintiffs to know the identities of unnamed company spokespersons without discovery. The Court should make clear that it is appropriate to accept as sufficient on a pleading motion an allegation that someone speaking for the company made a statement to a journalist or analyst when it has been attributed to a company spokesperson especially when, as in this case, the "unattributed" statements are entirely consistent with statements made in annual reports, SEC filings, and other public filings. If the policies underlying the nation's securities laws are to be effective, Rule 9(b) cannot reasonably require more.

CONCLUSION

For all the foregoing reasons, the Court should grant respondents' conditional cross-petition for a writ of certiorari if it grants the petition for a writ of certiorari.

Dated: February 23, 1994

Respectfully submitted,

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

A. Whether this Court should review the Second Circuit's decision which followed well-established legal principles, implicating no circuit conflicts, in concluding that defendants' comments about ongoing business discussions were not actionable in a securities fraud action where the complaint failed to allege the absence of a factual basis for those comments?

B. Whether this Court should review the Second Circuit's decision which followed well-established legal principles, implicating no circuit conflicts, in concluding that defendants were not liable for comments made by anonymous sources, newspaper columnists and financial analysts over whom defendants had no control?

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[1/] A description of the parties to the proceeding and petitioners' Rule 29.1 statement appear at pages ii and 1a–13a of the Petition for Writ of Certiorari.

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Respondents.

BRIEF IN OPPOSITION TO CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI

Petitioners/cross-respondents Time Warner Inc. ("TW") and the individual defendants filed a petition for a writ of certiorari requesting this Court to review the split decision of the Second Circuit upholding the Rule 10b-5 plaintiffs' irrational scienter theory. In response, respondents filed a conditional cross-petition in the event the Court grants the petition.[1/]

[1/] Different counsel filed two separate briefs in support of the cross-petition. They are referred to herein as "ZVI Cross-Pet." and "Zonon Br."

The "conditional" nature of the cross-petition underscores the conclusion that the issues raised by respondents do not involve unsettled questions of law or conflicts that merit plenary review by this Court.

COUNTERSTATEMENT

The factual background of the case is set forth in our Petition (at 2–4), to which we respectfully refer the Court. We here briefly summarize those portions of the record relevant to the questions raised by the cross-petition.

The complaint sets forth a series of general remarks by defendants (Pet. 24a-25a) concerning TW's ongoing talks with potential strategic alliance partners. The complaint concedes that those remarks were "true or issued with a reasonable basis and in good faith when originally made" (Compl. ¶ 53). But it alleges that those remarks later became misleading and that defendants should have disclosed, among other things, potential difficulties that arose as the talks progressed. The Second Circuit, like the District Court (Lasker, J.), unanimously held that those remarks were, as a matter of law, too cautious and indefinite to require later correction under the securities laws (Pet. 24a–26a, 56a–57a).

The complaint also sets forth, at some length, excerpts from a wide variety of financial analysts' reports and newspapers concerning the strategic alliance discussions (Pet. 21a–22a). Respondents concede that those third-party statements "were similar in nature and content to those directly attributed to petitioners" (ZVI Cross-Pet. 17). Those third-party accounts contain anonymous quotes, paraphrase remarks from alleged TW insiders, or merely report on TW's activities. The Second Circuit, like the District Court, unanimously held that, as a matter of law, defendants were not liable for comments by anonymous sources, reporters or analysts beyond their control (Pet. 20a–24a, 60a–64a).

REASONS FOR DENYING THE CROSS-PETITION

The questions raised by the conditional cross-petition do not merit review by this Court. The Second Circuit followed well-settled law. There are no conflicts among the circuits.

ARGUMENT

I.

THE SECOND CIRCUIT FOLLOWED WELL-SETTLED LEGAL PRINCIPLES IN HOLDING THAT DEFENDANTS' COMMENTS ABOUT POSSIBLE STRATEGIC ALLIANCES WERE NOT ACTIONABLE

Respondents claim that the Second Circuit ignored *Virginia Bankshares, Inc.* v. *Sandberg*, 111 S. Ct. 2749 (1991), in concluding that defendants' comments about possible alliances were not actionable (ZVI Cross-Pet. 12-17; Zonon Br. 21-23). That is a meritless claim. Applying traditional legal analysis, the Second Circuit merely held that the particular allegations of the pleading in this case were deficient. The opinion is consistent with *Virginia Bankshares*.

The statements in the complaint attributed to defendants (Pet. 24a-25a) speak solely in terms of *possible* or *potential* alliances with *unnamed* parties on *unspecified* terms and at *indeterminate* times. There are no predictions of success or details as to the progress of the talks, the identity of the parties, the business terms, or the timetable (Pet. 24a-25a). Respondents do not claim, in their briefs or complaint, that defendants' statements were false when made or that defendants' expectations lacked a basis in fact. On the contrary, the complaint alleges that defendants' statements were "true or issued with a reasonable basis and in good faith when originally made" (Compl. ¶ 53).

The Second Circuit unanimously concluded that those cautious remarks did not contain affirmative misrepresentations (Pet. 25a–26a):

> We agree with the District Court that none of the statements constitutes an *affirmative* misrepresentation. Most of the statements reflect merely that talks are ongoing, and that Time Warner hopes that the talks will be successful. There is no suggestion that the factual assertions contained in any of these statements were false when the statements were made. As to expressions of opinion and the projections contained in the statements, while not beyond the reach of the securities laws, . . . the complaint contains no allegations to support the inference that the defendants either did not have these favorable opinions on future prospects when they made the statements or that the favorable opinions were without a basis in fact.

(emphasis in original, citations omitted).

The Second Circuit also unanimously rejected plaintiffs' claim that defendants had a duty to publicize potential problems that may have arisen in the course of the alliance discussions:

> [T]he attributed public statements lack the sort of definite positive projections that might require later correction. The statements suggest only the hope of any company, embarking on talks with multiple partners, that the talks would go well. No identified defendant stated that he thought deals would be struck by a certain date, or even that it was likely that deals would be struck at all. . . . These statements did not become materially misleading when the talks did not proceed well.

(Pet. 26a) (citation omitted).

The Second Circuit's conclusions, which mirror those of the District Court,[2/] do not break new legal ground. The Court of Appeals simply concluded that defendants' remarks, as set forth in the complaint in this case, were not false or misleading.

Contrary to respondents' claims (ZVI Cross-Pet. 12; Zonon Br. 22), the decision of the court below does not conflict with this Court's opinion in *Virginia Bankshares*. The Second Circuit specifically cites that decision and explains why its rationale does not apply here (Pet. 26a). In *Virginia Bankshares*, this Court held that an expression of opinion may be actionable if there is no factual basis for the opinion, or if the defendant does not really believe the opinion. The Court declared that expressions of opinion may be actionable when it is "reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading." 111 S. Ct. at 2758. The Court added that "[a] statement of belief may be open to objection . . . solely as a misstatement of the psychological fact of the speaker's belief in what he says." *Id.* at 2759.

But here, as the Second Circuit and District Court emphasized, the views expressed by defendants did not lack a factual basis, nor was it alleged that defendants did not believe the

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[2/] The District Court declared: "Plaintiffs do not claim that such negotiations did not occur or that Time Warner conducted them in bad faith. . . . None of the attributed statements makes a specific representation as to progress toward completion of the talks or likely partners or any other false affirmative statement." (Pet. 56a). The District Court added that "defendants' statements simply expressed their enthusiasm about ongoing negotiations," and that the complaint was marked by an "absence of factual allegations showing that defendants made falsely optimistic predictions" (Pet. 56a-57a).

statements when made. The opinion below is thus fully in accord with *Virginia Bankshares*.[2/]

II.

THE SECOND CIRCUIT FOLLOWED WELL-SETTLED LEGAL PRINCIPLES IN HOLDING THAT DEFENDANTS ARE NOT LIABLE FOR STATEMENTS BY ANONYMOUS SOURCES, NEWSPAPER COLUMNISTS AND FINANCIAL ANALYSTS

Respondents claim that the Second Circuit's opinion conflicts with decisions by other courts (mainly district courts) in holding that statements by anonymous sources, newspaper reporters and financial analysts are not actionable (ZVI Cross-Pet. 17-28; Zonon Br. 19-26). The Second Circuit's opinion on this point reflects well-accepted law. There are no circuit conflicts or unsettled questions.

The stringent pleading requirements of Rule 9(b) in securities fraud actions—designed to reduce strike suits (Pet. 11 n.7)—require a Rule 10b-5 complaint to identify "the speaker[ ] and content of the alleged misrepresentations in the complaint" (Pet. 60a). The Second Circuit followed traditional law in holding that defendants could not be liable for statements by anonymous sources, newspaper reporters or financial analysts over whom they exercised no control (Pet. 20a-24a, 60a-64a).

Noting that these third-party statements "add little to the statements for which Time Warner is concededly responsible" (Pet. 20a), the court of appeals concluded:

[2/] The other precedents cited by respondents—*Mayer* v. *Mylod*, 988 F.2d 635 (6th Cir. 1993); *Hanon* v. *Dataproducts Corp.*, 976 F.2d 497 (9th Cir. 1992); and *Shapiro* v. *UJB Financial Corp.*, 964 F.2d 272 (3d Cir.), *cert. denied*, 113 S.Ct. 365 (1992)—merely repeat *Virginia Bankshare*'s holding that opinions are actionable if neither believed nor factually based. Those defects are not present here.

> Judge Lasker understood Rule 9(b) to require, at a minimum, that the plaintiff identify the speaker of the allegedly fraudulent statements. We believe that he was correct.

(Pet. 22a).

Far from imposing a "Draconian" interpretation of Rule 9(b) (ZVI Cross-Pet. 19), the court below followed a long line of unbroken precedents. *See, e.g., Raab* v. *General Physics Corp.*, 4 F.3d 286, 288-89 (4th Cir. 1993) (affirming dismissal of 10b-5 claim, holding, "The securities laws . . . do not require [a] company to police statements made by third parties for inaccuracies, even if the third party attributes the statement to [defendants]. Without control over [the analyst] report, any statement made by [defendant] personnel could be taken out of context, incorrectly quoted, or stripped of important qualifiers."); *In re Verifone Securities Litigation*, 784 F. Supp. 1471 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993) (dismissing 10b-5 complaint alleging that defendants were liable for statements by stock analysts); *Schwartz* v. *Novo Industri, A/S*, 658 F. Supp. 795, 799 (S.D.N.Y. 1987) (Weinfeld, J.) (dismissing 10b-5 action because court cannot infer fraud from a statement appearing in news article "over which defendant had less than complete control"); *Hershfang* v. *Citicorp.*, 767 F. Supp. 1251, 1259 (S.D.N.Y. 1991) (dismissing 10b-5 action where plaintiff "stitched together a patchwork of newspaper clippings and proclaimed the result a tale of securities fraud"); *In re Network Equipment Technologies, Inc. Litigation*, 762 F. Supp. 1359, 1367 (N.D. Cal. 1991) (striking allegations in a 10b-5 complaint based on statements of financial analysts). *See also State Teachers Retirement Board* v. *Fluor Corp.*, 654 F.2d 843, 850 (2d Cir. 1981) ("A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company.")[4/]

[4/] These precedents reflect the strong policy articulated in *Dirks* v. *SEC*, 463 U.S. 646, 658 & n.17 (1983), that market efficiency is (continued...)

Respondents' argument, in the final analysis, boils down to a demand for discovery in order to determine whether plaintiffs can create a cause of action—*i.e.*, whether there is any link between defendants and the anonymous and unattributed statements. (*See* ZVI Cross-Pet. 28.) That argument, if accepted, would gut Rule 9(b)'s rigorous requirements for pleading fraud actions and

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[4/](...continued)
significantly enhanced by efforts of analysts who "remain free" to obtain information from corporate sources. Permitting securities actions against corporations based on the independent musings of financial analysts and newspaper reporters would unfairly penalize companies for statements over which they have no control and impose on them the impossible duty of policing third-party comments. *See, e.g., Raab* v. *General Physics Corp.*, 4 F.3d at 288; *State Teachers Retirement Board* v. *Fluor*, 654 F.2d at 850.

The cases cited by respondents (ZVI Cross-Pet. 22-25)—distinguished by the Second Circuit and District Court (Pet. 22a, 60a-61a)—are clearly inapposite. *In re Ann Taylor Store Securities Litigation*, 807 F. Supp. 990 (S.D.N.Y. 1992), for example, involved statements in a press release issued by the defendant. *In re Columbia Securities Litigation*, 747 F. Supp. 237 (S.D.N.Y. 1990), involved a positive identification of the speakers of the allegedly fraudulent statements. *Cytryn* v. *Cook*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,409 (N.D. Cal. July 2, 1990), involved company press releases and allegations of statements to analysts by identified defendants.

open the floodgates to vexatious 10b-5 suits contrary to the policy of *Blue Chip Stamp* v. *Manor Drugstores*, 421 U.S. 723 (1975).

Conclusion

For all the reasons demonstrated above, the Court should deny the conditional cross-petition for a writ of certiorari.

Dated: New York, New York
March 14, 1994

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN RE: TIME WARNER INC. SECURITIES LITIGATION.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST and BARRY ZONON,

Cross-Petitioners,

vs.

STEVEN J. ROSS, N.J. NICHOLAS, JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER INC.,

Cross-Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY TO BRIEF IN OPPOSITION IN CONNECTION WITH CONDITIONAL CROSS-PETITION FOR WRIT OF CERTIORARI

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REPLY TO BRIEF IN OPPOSITION

Cross-respondents' brief in opposition argues that the conditional cross-petition should not be granted because the Second Circuit followed well-settled law in holding that cross-respondents' statements concerning strategic alliances, including statements by unidentified Time Warner spokespersons to the news media and financial analysts, which caused the price of Time Warner's stock to rise from $86 per share to $119 per share during the class period, were not actionable under the federal securities laws. Cross-respondents maintain that the decision below did not create a conflict among the Circuits. The conditional cross-petition demonstrated, however, that the Second Circuit's decision with respect to these issues merits review by this Court because it:

(1) undermines the philosophy of full and fair disclosure underlying the federal securities laws recognized by this Court in, inter alia, Basic, Inc. v. Levinson, 485 U.S. 224, 230 (1988); (2) ignored or misapplied decisions of this Court, including Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749 (1991); and (3) conflicts with decisions of other Circuits, see, e.g., Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1262 (4th Cir. 1993); In re Apple Computer Secs. Litig., 886 F.2d 1109, 1116 (9th Cir. 1989), cert. denied, 496 U.S. 943 (1990), that have recognized the materiality and market impact of statements reported by the news media and financial analysts.

I.

DEFENDANTS' STATEMENTS REGARDING STRATEGIC ALLIANCES WERE MATERIALLY MISLEADING UNDER THE FEDERAL SECURITIES LAWS

As demonstrated in cross-petitioners' opening brief, the Second Circuit's stated rationale for dismissing the public statements made by defendants prior to May 1, 1991, conflicts directly with controlling authorities from this Court and other Circuits. According to the Second Circuit, because defendants' pre-May 1, 1991, statements regarding strategic alliances were not "definite positive projections," they "did not become materially misleading when the talks did not proceed well" (Pet. 26a).[1] The decision below mischaracterized the challenged

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[1] Citations to the petition for certiorari filed by Time Warner Inc. and certain of its senior executive officers (together, "defendants" or "cross-respondents") are in this form.

statements, ignored an entire body of case law governing the actionability of general statements of belief and optimism, and constituted an unwarranted factual determination on a motion to dismiss under Federal Rule 12(b)(6).

While the Second Circuit analyzed defendants' statements only as if they were "forward-looking" or projections, in fact, defendants' statements were misstatements of fact. For example, on November 30, 1990, the Wall Street Journal quoted defendant Steven J. Ross ("Ross") as stating that Time Warner "continues to have serious talks," (Pet. 24a n.3), and on May 13, 1991, Business Week quoted Ross as stating that Time Warner was "making alliances at the subsidiary level," (id.). It is axiomatic that such statements gave rise to a duty to be completely truthful concerning the progress of defendants'

negotiations with potential strategic partners. See Roeder v. Alpha Indus., Inc., 814 F.2d 22, 26 (1st Cir. 1987)(when "a corporation does make a disclosure -- whether it be voluntary or required -- there is a duty to make it complete and accurate"); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-61 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969); Schlanger v. Four-Phase Sys., Inc., 582 F. Supp. 128, 133 (S.D.N.Y. 1984)(same). A statement that accurately discloses some facts, but creates a false or erroneous impression by omitting other facts necessary for a true understanding, is misleading under the federal securities laws. See McMahan & Co. v. Wherehouse Entertainment, Inc., 900 F.2d 576, 579 (2d Cir. 1990), cert. denied, 111 S. Ct. 2887 (1991) ("the disclosure required by the securities laws is measured not by

literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers"). Companies have a duty to correct and update prior material public statements that have become inaccurate or misleading. Courts consistently have held that, once a company speaks, it must tell the truth and update the facts to insure that the marketplace is not misled. See Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980) (company has a duty to correct prior material statements that have become inaccurate); In re Warner Communications Secs. Litig., 618 F. Supp. 735, 752 (S.D.N.Y. 1985), aff'd, 798 F.2d 35 (2d Cir. 1986) (same).

Moreover, even accepting the Second Circuit's characterization of defendants' statements as "forward-looking" or projections, the court below

erred in holding that these statements were not actionable under Rule 10b-5. The federal securities laws do not protect public statements only when they constitute "definite positive projections." Notably, the Second Circuit cited not a single case that supports such a proposition. To the contrary, courts have squarely held that forecasts, projections and general statements of optimism are actionable under the federal securities laws. See, e.g., In re Apple Computer Secs. Litig., 886 F.2d 1109 (9th Cir. 1989), cert. denied 110 S. Ct. 3229 (1990) ("projections and general statements of optimism may be actionable under the federal securities laws"[emphasis added]); Hanon v. Dataproducts Corp., 976 F.2d 497 (9th Cir. 1992) (same).

Courts have thus consistently rejected the argument that forward-

looking statements are not actionable because they are vague, conclusory or constitute corporate "puffing."[2] Thus, this Court has expressly held that statements may be actionable under the federal securities laws, "even when stated in conclusory terms." Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2758-59 (1991). Similarly, as held in Midlantic Corporation Shareholder Litig., 758 F. Supp. 226, 232 (D.N.J. 1990), a company and its management cannot exploit their own public statements by challenging them as "vague" after injured investors assert that those statements were false and misleading.

> To hold otherwise would allow corporations and ... management to issue statements calculated to

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[2] See, e.g., Hoxworth v. Blinder Robinson & Co., 903 F.2d 186 (3d Cir. 1990); Mayer v. Mylod, 988 F.2d 635 (6th Cir. 1993); In re Meridian Secs. Litig., 772 F. Supp. 223, 226 (E.D. Pa. 1991).

> mislead investors by couching them with glowing yet relatively vague language, knowing full well that the investing public would attach to them meanings inducing them to invest in a corporation they otherwise would avoid.

Here, defendants disseminated a stream of public statements concerning and updating the status of their strategic alliance negotiations that became increasingly positive and definitive during the class period.[3] As demonstrated above, those statements may be actionable under the federal

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[3] As noted in petitioner's opening brief, the Second Circuit itself accepted as true the proposition that defendants conveyed "positive messages" regarding defendants' search for strategic alliances and the "consummation" of significant partnerships (Pet. 17a). The District Court similarly found that defendants' statements concerning strategic alliances were designed to "drum up enthusiasm" for Time Warner stock "by proclaiming the advantages possible 'strategic alliances' could offer the company and its would-be partners and by reporting that negotiations were underway" (Pet. 55a).

securities laws, irrespective of whether they constituted "definite positive projections." The Second Circuit's dismissal on this basis was therefore erroneous and in clear conflict with authorities from this Court and other Circuits.

Cross-respondents' opposition to the cross-petition is devoted principally to a verbatim recitation of the Second Circuit's opinion. Moreover, notably absent from cross-respondents' brief is any attempt to legitimize the Second Circuit's apparent limitation of liability under the federal securities laws only to "definite positive projections."

Cross-respondents also fail to credibly reconcile the Second Circuit's ruling with this Court's holding in Virginia Bankshares. That decision is inapposite, cross-respondents maintain,

because here, the "views expressed by defendants did not lack a factual basis, nor was it alleged that defendants did not believe the statements when made." Br. at 5, 6.[4] Not only are these factual assertions inappropriate in the context of a motion to dismiss, they avoid the central point of this Court's decision in Virginia Bankshares with regard to the actionability of the challenged statements in this case; i.e., that publicly disseminated statements may subject the speaker to liability even if made in general, vague and conclusory terms. The Second Circuit's dismissal of the statements challenged here directly conflicts with this controlling legal principle.

The Second Circuit's dismissal of the pre-May 1, 1991, statements was

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[4] Citations to cross-respondents' brief in opposition are in this form.

erroneous for another reason as well. Ultimately, the Court concluded that defendants' statements regarding strategic alliances did not become "materially misleading when the talks did not proceed well" (Pet. 26a). The Court thus made a decidedly factual determination regarding the materiality of information that was fundamentally improper on a motion to dismiss based on the adequacy of the pleadings.

A fact is material if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). See also Basic, Inc., 485 U.S. at 231 (adopting the TSC Industries, Inc. standard in the § 10(b) and Rule 10b-5 context). Such questions are decidedly factual in nature and are

therefore reserved for the trier of fact.[5] In rendering its decision, therefore, the Second Circuit effectively arrogated to itself a function more properly left for the jury on a full and complete record. For this reason as well, the Second Circuit committed reversible error.

II.

STATEMENTS MADE BY UNIDENTIFIED CORPORATE "SPOKESPERSONS" TO JOURNALISTS AND ANALYSTS ARE ACTIONABLE UNDER SECTION 10(B)

Defendants' opposition is equally unpersuasive concerning statements by unidentified corporate "spokespersons" to the news media and financial analysts.[6] Although it recognized the

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[5] Brickman v. Tyco Toys, Inc., 731 F. Supp. 101, 104 (S.D.N.Y. 1990) ("The materiality of undisclosed information to investors is generally an issue for the trier of fact to ascertain").

[6] Plaintiffs are not -- as defendants assert, (Br. at 6) -- relying on statements made by newspaper

(continued...)

potency of these statements by stating that some "would bolster plaintiffs' case considerably," (Pet. 21a), the Second Circuit dismissed these claims pursuant to Rule 9(b) of the Federal Rules of Civil Procedure reasoning that plaintiffs were required, without the benefit of discovery, to plead the names of the spokespersons who made the statements.

In defense of the Second Circuit's decision, defendants argue that the opinion below does not create a split among the Circuits and, therefore, does not merit review by this Court. In fact, however, the Second Circuit's

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[6](...continued)
reporters and financial analysts. The complaint alleges that defendants themselves made misleading statements concerning Time Warner's strategic alliance negotiations to the financial media and securities analysts with the explicit knowledge and intent that they would be given the widest possible dissemination by these organizations.

stated rationale for precluding litigation based upon statements by "unidentified" company spokespersons -- that investors do not rely upon information that cannot be attributed to a named individual within the company -- is at odds with the decisions of several other Circuits which correctly recognize the power of such media reports to affect the market's perception of a company's worth. For example, both the Fourth and Ninth Circuits have granted summary judgment dismissing Rule 10b-5 claims on the grounds that negative press reports disclosed the facts plaintiffs had claimed the defendants wrongfully withheld from investors. See Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1262 (4th Cir. 1993); In re Apple Computer Secs. Litig., 886 F.2d 1109, 1116 (9th Cir. 1989), cert.

denied, 496 U.S. 943 (1990).[7] If such press reports can exculpate defendants from Rule 10b-5 liability they also must provide a basis for such liability in appropriate cases.[8]

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[7]Indeed, there are conflicting decisions within the Fourth Circuit with respect to this issue. The decision of the panel in Raab v. General Physics Corp., 4 F.3d 286 (4th Cir. 1993), cited by defendants, holding that unattributed statements in news and analyst reports cannot provide basis for 10b-5 liability is inconsistent with Cooke's holding that statements by the media and financial analysts constitute notice to the market.

[8]The "long line of unbroken precedents" cited by defendants, Br. at 7, is neither long nor unbroken. In their opening brief, plaintiffs cited four decisions that expressly recognized that a corporation can be held liable for statements by unidentified spokespersons. On the other hand, three of the six decisions cited by defendants do not support the Second Circuit's decision on this issue. State Teachers Retirement Board v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981), does not even address this issue. In re Verifone Secs. Litig., 11 F.3d 865, 871 n.8 (9th Cir. 1993), the Ninth Circuit explicitly declined to reach the company's argument that it could not be charged with any misstatements or omissions in analyst

(continued...)

Finally, defendants' in terrorem argument that permitting plaintiffs to take limited discovery with respect to the identities of the unidentified spokespersons will open the floodgates and invite frivolous litigation completely ignores the good-faith basis for plaintiffs' allegations in this case that the challenged statements did indeed originate within Time Warner. All of these statements were perfectly consistent with statements by the company and its senior officers and

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[8](...continued)
reports since it found that the challenged statements were not otherwise actionable under the federal securities laws. Finally, in Schwartz v. Novo Industri, A/S, 658 F. Supp. 795, 799 (S.D.N.Y. 1987), the court did not hold that the statement reported by the media was not actionable because it was unattributed (it was in fact attributed to the company's president), but because it was a projection and plaintiff had failed to allege facts demonstrating that the defendants did not have a reasonable basis for making the projection.

directors in SEC filings, annual reports, and elsewhere.

CONCLUSION

For all the reasons set forth above and in plaintiffs' conditional cross-petition, the conditional cross-petition for a writ of certiorari should be granted if the Court grants defendants' petition for a writ of certiorari.

Dated: New York, New York
March 29, 1994

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